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Forbes

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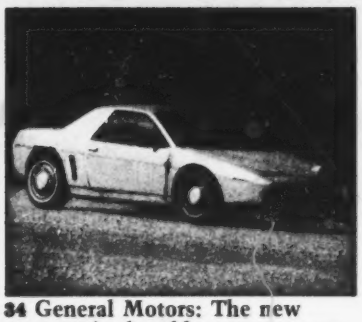
Forbes

May 25, 1981
Volume 127, Number 11

100 Cover Story: "In the future," says Jim Robinson of American Express, "our motto could be: 'Don't stay home without us.' "



34 General Motors: The new strategy is the old master's game plan, slightly modified.

75 Blank Tapes: Why Jessica Epstein—and millions of other young people—are no longer every record-executive's dream.

84 The Up-And-Comers: Hasbro Industries started straightening out the day Steve Hassenfeld decided it was the company, not the industry, that was the problem.

Features

The Bond Market: A Turning Point?
Bond yields have far outstripped inflation. Maybe someone will notice soon. 31

Savings And Loans: Enough Is Enough
Fed up with political decisions that make no economic sense, California's S&Ls are fleeing state regulation in favor of national charters. 32

Government Pensions: This Year Is Different
Mission Impossible just might succeed. 33

Companies: General Motors
"We're mean and lean and tough and running fast," says Chairman Roger Smith. Is that just Detroit's chronic optimism talking? Maybe—but GM also has a strategy, one right out of Alfred Sloan's book. 34

Auto Imports: Less Than Meets The Eye
Will Japan really cut back? Not by much. 38

As I See It: Peter Drucker
If we can't easily compete with the Japanese, he says, Wall Street must shoulder much of the blame. 42

The Skin Care Industry: Vanity And Big Profits
An old pitch booms anew on the graying of America. 47

Energy: Garbage In, Garbage Out?
A new—but perhaps unnecessarily complex—way of financing trash-to-energy plants. 50

Companies: Stanadyne
Paul Mongerson's company has been around since 1876 and recently became a major GM supplier. But Mongerson isn't ruffled. He just quit making horseshoe nails. 54

Blank Tapes: Fast-Forward
Taping music from a phonograph or radio for *personal* use isn't against the law, and today's technology makes it cheaper than buying a record. That's why blank tape sales have tripled since 1973 and are still climbing. 75

Motion Pictures: Cinema Verité In Big D
With Dallas in the lead, Texas has become the largest regional film center in the U.S. 78

Fashion: Haute Couture's Low-Cost Producer
Statuesque Kim Dawson started a business where none existed before. 80

The Up-And-Comers: Hasbro Industries, Inc.
Only after the rest of the industry had written his company off did Steve Hassenfeld come to grips with it. 84

Companies: Brown-Forman Distillers
The house that Jack Daniel's built. 92

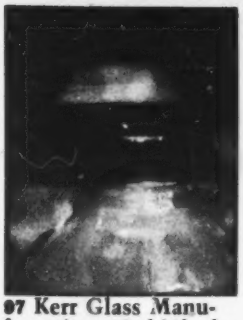
Companies: Kerr Glass Manufacturing Corp.
While other bottlemakers are hedging their bets, Bill Kerr has poured nearly $149 million into his glassmaking operations. The glass bottle, he says, is coming back. 97

Cover Story: The New American Express
You don't always get synergy when you put two successful but disparate organizations together; sometimes you get disaster. The merger of American Express and Wall Street's Shearson Loeb Rhoades Inc. is either going to be a beautiful piece of synergy or a $1 billion disaster. 100

Companies: A.C. Nielsen Co.
It's a massive data bank these days that pays far more attention to the supermarket than to the TV tube. 110

Companies: Akzona Inc.
Claude Ramsey has stuck with synthetic fibers as if he intended to be the last survivor. That, in fact, may be his trump card. 114

Companies: Springs Mills, Inc.
Getting out of the freezer. 115



97 Kerr Glass Manufacturing: "I think the glass industry fooled itself for years," says Bill Kerr.

114 Akzona, Inc.: Been down so long it looks like up from here.

135 Pitney Bowes: It's nice to have a near-monopoly business to fall back on when you're sailing into hazardous waters.

180 The Money Men: SAFECO's Bruce Robb—bonds are the base, but stocks are the turn-on.

Money And Investments

Companies: Intellectics
Who knows an organization better, says this contrarian consulting firm, than its own people? 118

Companies: Pitney Bowes
"We're not putting Xerox out of business" by expanding in the copier business, says Fred T. Allen. He's not kidding about that; but, then, there are reasons he can afford to make haste slowly. 135

Taxing Matters: Some Help For The Little Guy
A clever new tax bill offers both a sweet break for investors and capital for the small businessman. 138

The Numbers Game: Zero Coupon Bonds
The only problem, it would seem, is who would buy them? As it turns out, pension funds may be happy to. 140

Faces Behind The Figures

Haruo Yamaguchi, *Nippon Telegraph & Telephone* 146
George Shultz, *Bechtel Group* 146
David M. Roderick, *U.S. Steel* 146
John Heimann, *ex-Comptroller of the Currency* 148
Joseph Flannery, *Uniroyal* 148
Karl D. Bays, *American Hospital Supply Corp.* 152
William F. Andrews, *Scovill Inc.* 152
John Bremridge, *Hong Kong Crown Colony* 153
T. Ludlow Ashley, *General Public Utilities* 154
Mark Meagher, *Penthouse International* 154

Personal Affairs

There's a clear lesson in the travail of the Washington *Post*: The manufacture of bogus academic credentials is a growing problem, from which no company or institution is immune. Also: tax-free dividends; contralight airplanes; mobile homes; the silver lining in gold losses; alternative mortgages; and what you save at the self-service pump. 155

What's Ahead For Business? 25

The Forbes Index 26

The Forbes/Wilshire 5000 Review 171

The Money Men: Bruce Robb Of SAFECO
"Some people call us bottom fishermen." 180

The Streetwalker: Ebullience In The Backwoods
An earnings bang coming in forest products? Also: why British investors are bullish on Mrs. Thatcher. 181

Statistical Spotlight: Power Play
There's life in those battered utilities stocks. 183

Columnists

Ben Weberman 166
Heinz H. Biel 168
John Train 172
Richard B. Hoey 173
Stanley W. Angrist 174
Ashby Bladen 176
Srully Blotnick 178

Departments

Side Lines 6
Trends 8
Follow-Through 12
Readers Say 17
Fact and Comment 19
Other Comments 22
Editorial Index 186
Flashbacks 187
Thoughts 188

Photos: p. 6 top Granger Collection; bottom Tony Korody/Sygma; p. 8 François Lachon/Gamma Liaison; p. 12 Movie Star News; pp. 32, 146 Jim McHugh; p. 35 Jim Dunne; p. 38 Jean Pierre Laffont/Sygma; p. 42 Ken Rogers/Black Star; pp. 50, 54, 75, 84, 91, 148 center Bill Kelly; pp. 52, 104 Patrick Pagnano; p. 78 Les Wollam; p. 82 John Grossman; pp. 92, 138 William Strode/Woodfin Camp; p. 98 Steve Murray; pp. 101, 118 James Pozarik/Gamma Liaison; p. 102 Thomas Lea; pp. 110, 152 top Richard Faverty; p. 114 Dan Miller/Black Star; pp. 115, 117 Ron Chapple; p. 135 Werner Wolff/Black Star; p. 148 top Tom Barr/Black Star; p. 152 bottom Barry Rabinowitz; p. 153 John Moss/Black Star; p. 154 top Eric Poggenpohl; p. 154 bottom Robert Forbes; pp. 156, 158 Dave Gustaison; p. 180 Doug Wilson/Black Star

Illustrations: pp. 142, 182 Chas. B. Slackman; p. 155, Doris Ettlinger

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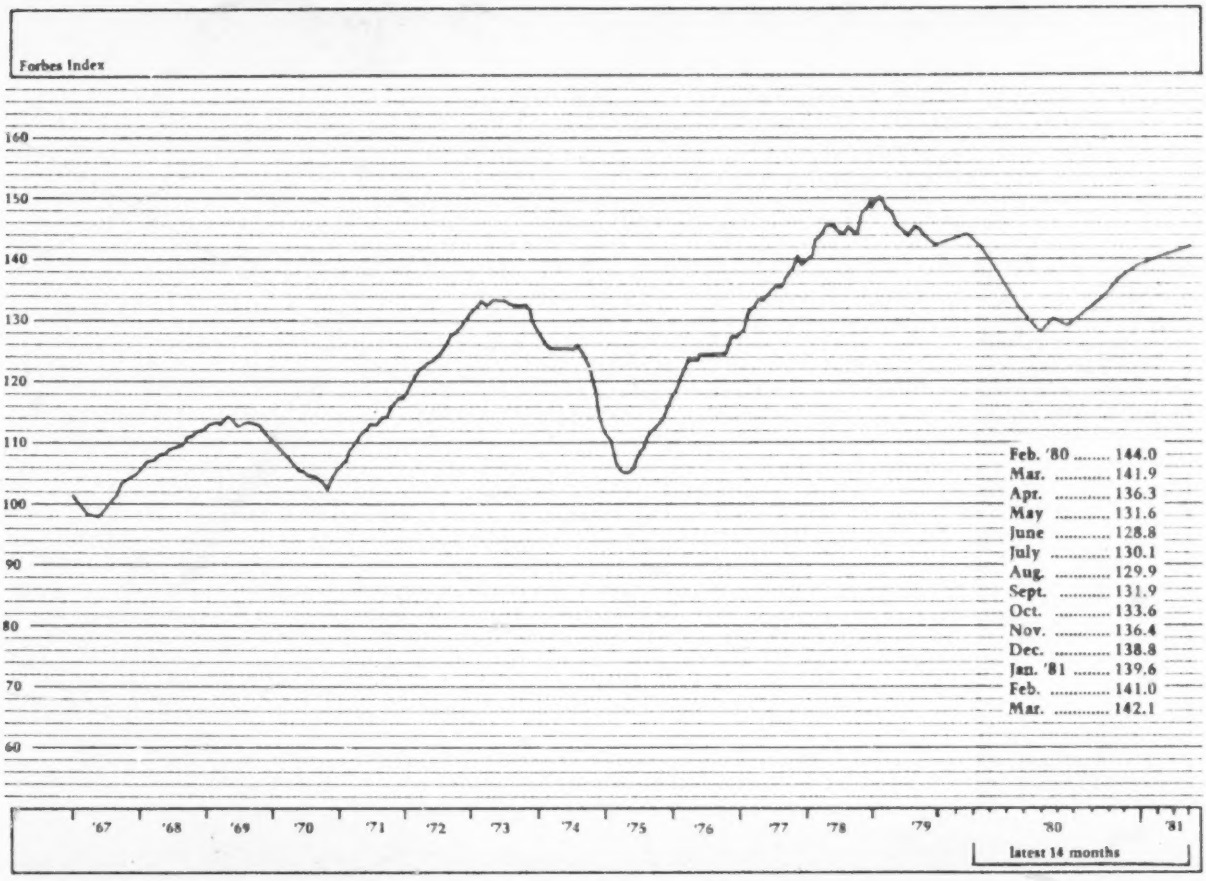
The Forbes Index



The Forbes Index Components

The economy's last hurrah? This issue the Forbes Index is still climbing, but don't be surprised if there's a downturn soon. Much of the spring strength comes from housing starts, which were up smartly in March. With interest rates soaring, however, that surge is unlikely to continue. At the same time, unemployment claims are rising fast—an ominous portent.

The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements:

Total industrial production

New claims for unemployment compensation

The cost of services relative to all consumer prices

The level of new orders for durable goods compared with manufacturers' inventories

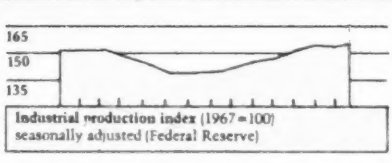
Total retail sales

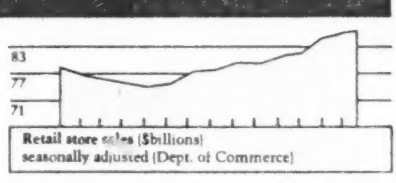
New housing starts

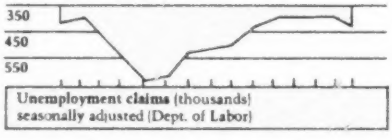
Personal income

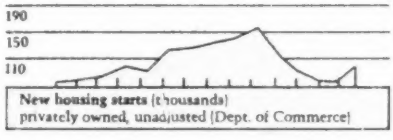
The change in the amount of consumer-installment debt outstanding

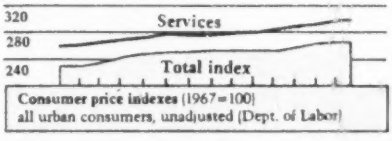
To measure these eight elements, Forbes monitors 11 series of U.S. government data. The last 14 months' data for each series is presented at right.

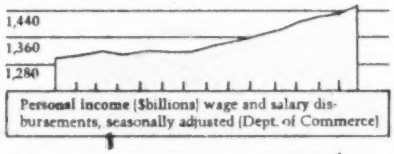


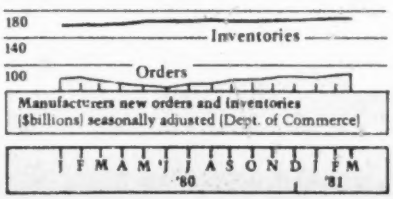


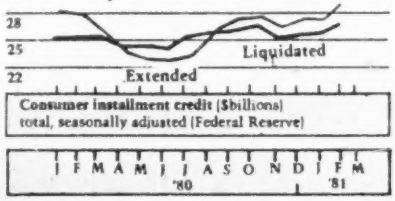












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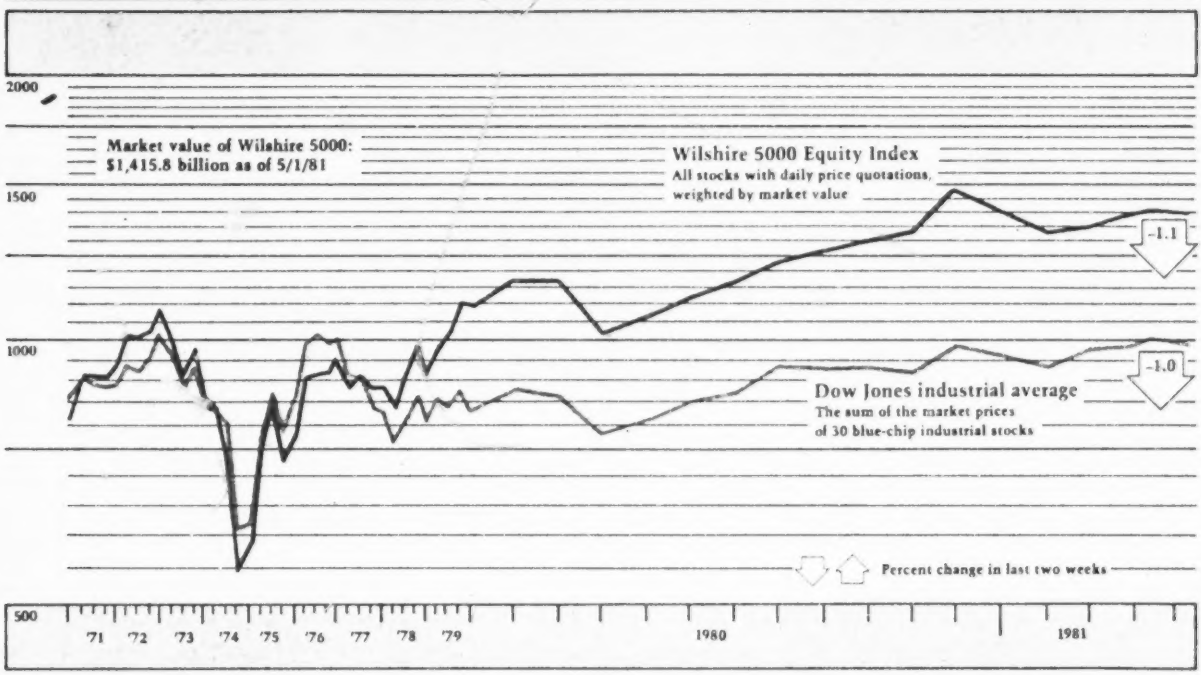
The Forbes/Wilshire 5000 Review



It's still a flip-flop market. One week, when traders hear a round of good news about inflation or interest rates, the averages surge ahead. Then, the second the headlines turn sour, a selling deluge hits. The message: Investors are confused; they change their minds with every wiggle of the economic indicators. Not an atmosphere likely to produce any solid price gains.

Over the past four weeks, both the Wilshire and the Dow have marked time. The only real advance came from NASDAQ stocks, which gained nearly 2% in value. The ASE, meanwhile, led all markets down—dropping by 3.5%. Over the longer term, however, the smaller stocks were clearly the place to be. Over-the-counter investments have increased in value by better than 50% during the past 52 weeks. That's twice the gain of a typical NYSE stock.

Still, for a dose of reassurance look at the 52-week performance figures broken down according to investor yardsticks. It has been a challenge to find a loser. High volatility, high P/E shares have nearly doubled. Nearly all other issues have moved up by 30% or more. Even stocks with fat dividends offered total returns of over 20%, when income and price appreciation are combined. How do you beat inflation? For the future, who knows. But over the past year, Wall Street was practically a sure thing.

Close-up On The Equity Markets

Performance of five leading indexes

Percent change	Wilshire 5000	Dow Jones industrials	NYSE Composite	ASE Market Value Index	NASDAQ Composite
in last 4 weeks	-1.1	-1.1	-1.8	-3.5	1.9
in last 52 weeks	30.6	22.8	27.8	39.8	54.5

Stock performance based on five key investor yardsticks

Percent change	Volatility *		P/E multiple		Dividend yield		Growth profile†		Share price	
	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	2.4	0.7	0.1	2.7	0.8	2.7	2.6	1.0	-0.6	4.0
in last 52 weeks	86.6	21.3	80.8	40.5	15.7	65.1	72.1	33.8	39.5	66.6

* A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations; low-volatility issues are more stable.
† A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 5/1/81. Prepared by Wilshire Associates, Santa Monica, Calif.

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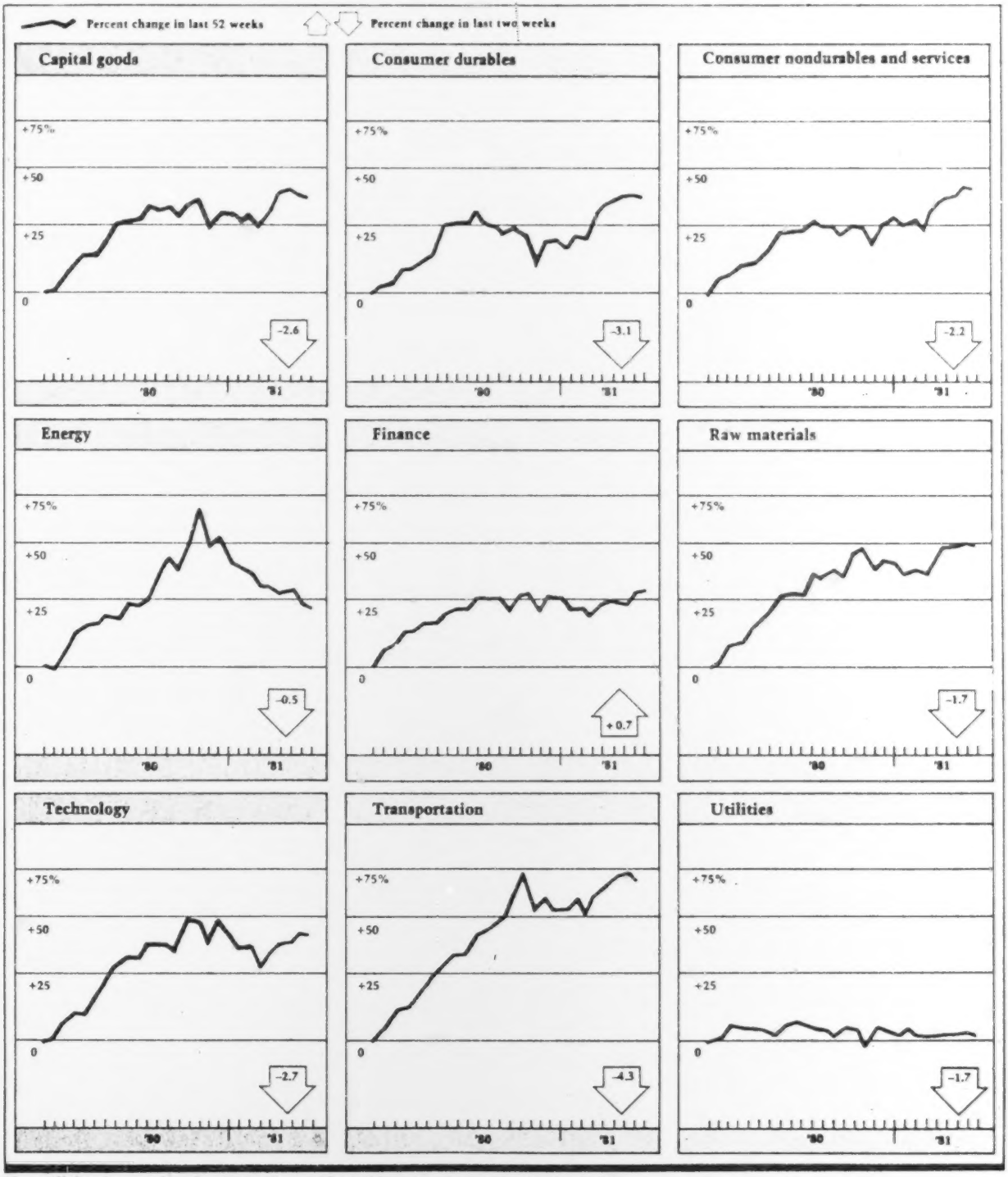
Where The Action Is

Don't ask your broker, buy his firm. Takeover fever hit the securities business—and that accounts for the only gain in a round of industry group figures dominated by profit-taking. Finance stocks were up just slightly, however, while several recent winners took a drubbing. Energy companies, though, did relatively well, and there are signs that their six-month decline may be ending.

Transportation stocks, for example, led the market down—and the graph of their performance over the past year leaves an ominous trail. Twice now, these companies have hit the line that marks 75% annual gains, and twice they have failed to advance further. On the plus side, however, the 50% gain line looks even more clearly like a trading bottom. So the graph marks tentative buy and sell levels.



Note: All data for periods ending 5/1/81. Prepared by Wilshire Associates, Santa Monica, Calif.

Beaten, battered and boring, electric utilities have languished for years. But recently, some bulls have begun to rage on Wall Street.

Power play?

By Steve Kichen and Newcomb Stillwell

I HAVEN'T BEEN SO aggressive since 1975," the man says, a little breathless. He is John Attalienti, senior utility analyst at Argus Research Corp., and it's not hard to understand his excitement. Squeezed by the cost push of inflation and the demand pull of politically motivated regulators, the electric utility companies he follows have been anything but healthy for a long, long time. And their slow-growing, high-yielding, interest-sensitive stocks have done even worse: As interest rates have ratcheted ever upward, electric utilities have traded down, down, down. . . .

But not any more, thinks Attalienti. The reason? Reaganomics means disinflation means lower interest rates. "We think long-term interest rates are headed on a substantial downward drift, starting in the very near future and continuing into 1982," he says. "That augurs well for utilities. Most are selling at 75% of book value, and we think they'll be back at book by the middle of 1982." That means a 33% *average* gain.

Yield, of course, is but another way of saying dividend, and utility stocks go up not only on falling interest rates but also on rising dividends. Attalienti sees some good news there, too; less inflation and lower interest rates, after all, are good news for any capital-intensive industry, and electric utilities are no exception. Another big boost comes from the regulators: who are beginning to understand numbers like those in the middle table on page 184, which shows what utility earnings really look like when adjusted for inflation's impact. As a result, they are beginning to realize that historical cost-based rate awards are rather less than adequate, so they are getting more generous with relief. Also, with demand slowing as a result of higher electricity prices, construction plans have been trimmed—good news, since the lower operating costs per kilowatt hour for a new plant are more than offset by higher construction and financing charges, so more capacity means tighter margins. And not just a little bit tighter, either: As the table at the top of page 184 shows, even some of the slowest-growing utilities do a fearsome amount of construction compared with industrials.

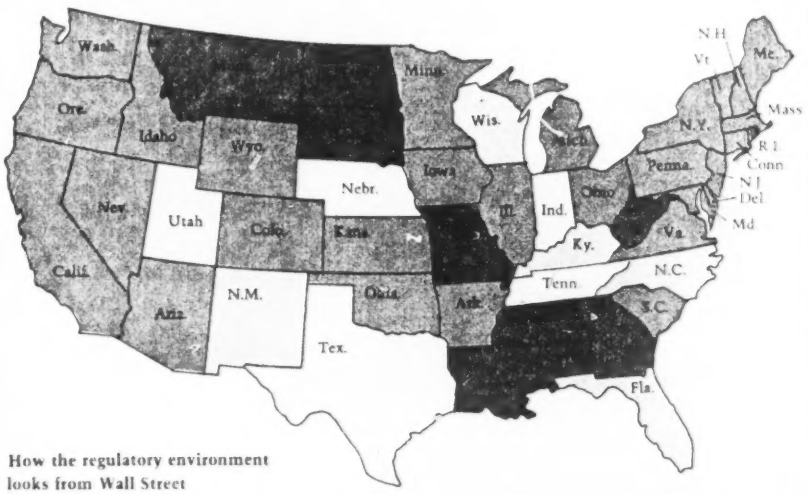
"The less growth a utility has today, the better," says Attalienti. "More and more managements are getting it through their heads that there is an elastic relationship between price and demand. And as financial management becomes increasingly predominant over the engineering mind set, more and more are getting it through their heads that they'll have to live with less reserve capacity than in the past." He concludes: "Add it up and the bottom line is better dividends on better earnings and lower payout ratios, with some companies playing catch-up for dividend growth that has trailed inflation in the past." That means 33% *plus*.

So who to pick? As befits a sober utility analyst, Attalienti grows cautious. "Go with quality," he says, "companies that can weather a storm, as a hedge in case the scenario is wrong, even though you'd get a slightly better play in the initial stages of a utility rally with higher-yielding, lower-quality issues." By quality, he means companies like Florida Power & Light, Florida Power Corp., Northern States Power, Potomac Electric, Southern California Edison, Texas Utilities, Utah Power & Light and Wisconsin Electric Power, among others. That's a lot of companies, but then there are a lot of utilities.

And Attalienti, *mirabile dictu*, isn't alone. Almost as bullish, though a little chastened, is Daniele Seitz of Smith Barney. "We would have preferred the interest rate decline not to have been interrupted," she says, "but our fundamental outlook hasn't changed." She also agrees with Attalienti on the prospect of robust dividend growth on stronger fundamentals, which she feels will prolong a

Rating the regulators

State utility commissions determine industry rates of return, so they can affect profits as much as supply and demand. That's why investors should watch election results and political appointments as closely as balance sheets.



How the regulatory environment looks from Wall Street

Excellent | Above average | Average | Below average | Poor

Note: Tennessee and Nebraska are not rated because these states do not have investor-owned utilities.
Source: Salomon Brothers

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Utility stocks: a consumer's guide

Who's growing, who's shrinking

Time was when high-growth companies were Wall Street favorites—but not so today. Booming kilowatt-hour demand means lots of expensive construction and the need for frequent rate hikes. So many analysts favor slow-growth utilities with healthy reserve capacity already in place.

Company	Total kwh sales change 1979-80	Reserve margin 1980[1]	Construction 1980-82 as % of total capitalization[2]	Recent price	Indicated yield
Increases					
Central & South West	9.1%	24.3%	66%	13¾	11.5%
Public Service Co of NM	8.9	18.3	71	22⅛	12.1
Southwestern Public Service	8.5	24.5	45	11⅝	11.9
Texas Utilities	8.1	38.3	43	18⅝	10.1
The Southern Co	7.5	21.2	46	11½	14.1
Decreases					
Northern Ind Public Service	–7.6%	38.8%	69%	10⅞	13.8%
Detroit Edison	–7.2	27.3	55	11½	13.9
Cleveland Electric Illuminating	–4.6	39.2	40	14⅜	14.5
Toledo Edison	–4.2	34.4	40	16	14.3
Nevada Power	–3.2	18.5	81	18⅞	12.9

[1]Reserve margin shows the relationship between spare generating capacity and peak load demand.
[2]Data from Argus Research Corp.

Who's hurt least by inflation

Rising prices ravage capital-intensive utilities, as this analysis of current-cost earnings indicates. For only a few firms does the ratio of inflation-adjusted profits to reported income top 50%; the great bulk of utilities have little real earnings at all. And, at the bottom of the list, deficits are massive.

Company	1980 EPS: reported EPS	1980 EPS: current cost	Current-cost EPS as % of reported EPS	Price/current-cost EPS	Indicated yield
Best					
Iowa-Illinois Gas & Electric	$2.69	$2.18	81.0%	7.3	13.8%
Public Service Co of NM	3.36	2.25	67.0	9.8	12.1
Central Louisiana Energy	3.95	2.63	66.6	16.2	2.8
Toledo Edison	2.56	1.66	64.8	9.6	14.3
Long Island Lighting	2.53	1.40	55.3	10.2	13.1
Worst					
General Public Utilities	$0.34	d$ 2.37	NM	d	—
Kentucky Utilities	1.51	d 2.35	NM	d	14.0%
Florida Power & Light	3.94	d 3.35	NM	d	10.8
Central Maine Power	1.67	d 1.15	NM	d	14.5
Savannah Electric & Power	1.22	d 1.76	NM	d	12.3

NM: Not meaningful. d: deficit.

Who's paying tax-free dividends

Tax and income accounting differences made these companies' entire 1980 dividends a return of capital—and thus free from income tax. Still, the benefit stems from heavy construction spending, which may cause problems later. What's more, some payouts in 1981 could be taxable.

Company	S&P's stock ranking	Recent price	Indicated dividend	Indicated yield
Cleveland Electric Illuminating	A–	14⅜	$2.08	14.5%
Detroit Edison	B+	11½	1.60	13.9
Long Island Lighting	A–	14¼	1.86	13.1
NY State Electric & Gas	A–	14⅝	1.88	12.9
Ohio Edison	B+	12⅛	1.76	14.5
Pennsylvania Power & Light	A–	17⅛	$2.24	13.1%
Public Service of NH	A–	15	2.12	14.1
Rochester Gas & Electric	A–	12¾	1.52	11.9
Toledo Edison	A–	16	2.28	14.3
Virginia Electric & Power	A–	11½	1.40	12.2

Sources: Standard & Poor's; Merrill Lynch; Duff and Phelps, Inc.; FORBES.

Statistical Spotlight

recent, anomalous development: The average utility stock yield is now below that of long-term government bonds; traditionally, the reverse was the case.

"The prospect of better earnings and dividends means that this relationship will continue for at least a year," she says. On whom to choose she parts company, though. Seitz has an eye for the high yielders, which look very cheap. The spread between the highest and lowest utility yields has widened on the strength of the higher-quality issues and is currently over 3%, very high by historical standards. "The spread is going to be corrected, once we get a slight decline in interest rates," she says. Among the stocks to buy: Allegheny Power, Baltimore Gas & Electric, Commonwealth Edison, Minnesota Power & Light, Philadelphia Electric and Toledo Edison. Strong companies, she thinks, and at an average of 13.5%, high yielders indeed.

And likely to stay that way, if you believe Mark Luftig of Salomon Brothers. "There are two kinds of people out there," he says of his competitors, "those who think rates have peaked, and those who see companies over the hump on construction, with improving fundamentals. We don't see rates coming down, and we think talk of better fundamentals is premature." All this Kaufmanesque gloom is not to say that there isn't money to be made in utilities, however: By trading selected issues identified by Salomon's computer model, Luftig claims his institutional clients have been posting gains of up to 20% a year. Right now he likes Boston Edison, Central Illinois Light, Indianapolis Power & Light, New England Gas & Electric, Northern Indiana Public Service, all of which are at least 5% cheaper than the computer says they should be.

Admittedly, that is not a game a man paying retail commissions can profitably play. Thus, for the long-suffering individual investor Luftig has another idea: companies paying return of capital dividends, some of which, like those listed in the table at the bottom of this page, are taxable solely as capital gains. "Someone in the 50% tax bracket can get the after-tax equivalent of a bond yielding 20%-plus," he says. "If you borrow the money and deduct the interest, you have an arbitrage an individual can take advantage of." Risky? "Return of capital is a sign of weakness, sure, but there is no question that most of these companies will keep paying dividends." Particularly interesting, he thinks, are Long Island Lighting Co., Middle South Utilities, New York State Electric & Gas, Niagara Mohawk, Pennsylvania Power & Light and Virginia Electric & Power Co.

Furthermore, if you've a mind to spec-

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ulate, Luftig suggests GPU, which has languished while the politicians try to do something about Three Mile Island. "I wouldn't recommend it for a fiduciary," says Luftig, "but I see a movement in Washington and at other utilities to help them somehow. There's a vague glimmer of light at the end of the tunnel, and with any luck it won't turn out to be a gorilla with a flashlight."

Considerably less sanguine is S. Arlene Barnes of First Boston. She worries that GPU could get squeezed this summer, if a continuing coal strike limits its ability to buy power from other utilities and is dubious of the prospects for any early bailout. She's unenthusiastic, as well, about return of capital dividends, citing the costs and hassles for many investors of keeping tax returns open for the three years it usually takes the IRS to audit the utility paying them. "And you have to be very nimble on your feet," she says, "because an unexpectedly good year can make a return of capital dividend fully taxable very quickly."

Barnes is even gloomier on the prospects of the industry as a whole, which, she notes, ended the first quarter with very high levels of short-term debt. And with many utilities already seriously overburdened with long-term debt—some with frighteningly low interest expense coverage—the urge to refund that short debt with equity could prove irresistible on any stock price improvement. "The pressure of new common issues," she says, "could stymie any effort at a sustained rally, if in fact, which we do not expect, there is a decline in interest rates."

She worries, too, that AA utility bonds currently yield more than utility stocks, a situation likely to be corrected on any improvement in rates. "That means you are likely to get better performance with bonds," says Barnes. She does, however, think that a few utility issues are currently underpriced: Cincinnati Gas & Electric, Pennsylvania Power & Light, South Carolina Electric & Gas, and a couple of others she can't talk about because First Boston will shortly be underwriting securities for them. Consider: If a grimster such as Barnes likes them, they might well be real stars.

There are other stars, too, according to Leonard Hyman of Merrill Lynch. To wit: Central Illinois Light, Central Illinois Public Service, Delmarva Power & Light and Madison Gas & Electric, all much stronger, he thinks, than their high yields imply.

"The market," says Hyman, "is not distinguishing between companies with high yields and decent prospects and companies with just high yields." With the exception of stocks like these whose yields are out of line with their prospects, he doesn't see much to recommend utility stocks at the moment. "If rates go down, you'll probably do better with bonds," says Hyman, sounding older and wiser. "Frankly, I'm not sure what to think about interest rates anymore, and I'm not sure I believe what anyone else says." Now there is a man you can identify with.

Shocking diversity

While it's true that one horse does not a horse race make, current opinion among Wall Street utility analysts resembles nothing so much as this year's Kentucky Derby: a lot of entries and not much consensus—on interest rates, the best-priced stocks, even perhaps the time of day. Herewith a list of utilities in favor now. It includes quick-starters, some come-from-behinds and a long shot or two. As the bookies say, you pays your money and you takes your choice.

Company	Recent price	Earnings per share 1980	Current-cost EPS as % of reported EPS	Total kwh sales change 1976-80	Change in dividends 1976-80[1]	Indicated yield	Payout ratio	Book value per share	Pretax fixed charge coverage[2]	Regulatory environment[3]
Allegheny Power	14⅜	$2.59	NM	19.6%	11%	13.6%	75.7%	$21.07	2.7	C–
Baltimore Gas & Electric	22⅛	3.64	0.8%	16.7	20	11.6	70.3	30.79	3.3	C
Boston Edison	20¼	3.75	NM	9.3	11	13.8	74.7	31.01	2.3	NA
Central & South West	13¾	2.45	8.2	30.8	25	11.5	64.5	17.04	3.5	B–
Central Illinois Light	13¼	2.00	NM	17.5	6	13.7	91.0	18.26	3.3	C
Central Illinois Public Service	10⅝	1.54	NM	12.9	10	13.6	93.5	13.80	3.1	C
Cincinnati Gas & Electric	15	2.25	5.3	16.8	23	13.6	90.7	19.94	2.5	C+
Commonwealth Edison	18⅝	2.97	45.8	6.7	9	14.0	87.5	26.72	1.9	C
Consolidated Edison	28⅛	4.67	NM	12.0	68	10.5	63.4	45.23	3.7	C
Delmarva Power & Light	11⅜	1.60	NM	12.0	23	13.4	95.0	15.74	1.9	C+
Florida Power	14¼	1.66	NM	26.9	46	11.5	98.8	18.07	2.7	B+
Florida Power & Light	28¼	3.94	NM	28.0	69	10.8	77.2	34.95	2.7	B+
Houston Industries	27½	4.71	40.3	34.0	66	10.8	62.8	35.14	3.5	A
Indianapolis Power & Light	19⅛	3.68	29.3	11.4	21	12.5	65.2	24.83	3.8	A
Madison Gas & Electric	12⅞	2.21	5.0	36.7	35	13.4	77.8	19.56	4.1	B
Minnesota Power & Light	16½	2.55	13.7	53.6	23	12.8	83.1	27.95	2.9	C+
New England Electric System	21¼	3.50	NM	2.9	28	11.8	71.4	27.10	3.2	C+
New England Gas & Electric	14¼	3.01	NM	–9.8	27	13.2	62.5	20.65	3.3	C
Northern Ind Public Service	10⅞	1.47	NM	2.9	7	13.8	102.0	17.11	2.5	A
Northern States Power	22⅞	3.23	NM	14.1	21	10.6	74.9	28.17	3.8	C+
Pennsylvania Power & Light	17⅛	2.64	23.1	10.5	17	13.1	84.8	24.54	2.1	C–
Philadelphia Electric	12½	2.00	1.0	5.1	10	14.4	90.0	18.64	2.1	C–
Potomac Electric Power	13⅝	2.10	9.5	15.5	26	11.7	76.2	17.00	3.4	C–
South Carolina Electric & Gas	13½	2.02	nil	14.5	15	13.5	90.1	18.29	2.2	C+
Southern California Edison	25⅝	3.50	NM	11.6	65	11.6	84.6	32.90	2.0	C+
Southern Indiana G&E	17⅜	3.43	NM	26.9	38	10.7	54.8	23.37	5.6	A
TECO Energy[4]	19⅛	3.12	11.2	20.2	39	9.0	55.1	19.61	4.1	B+
Texas Utilities	18⅝	3.18	34.6	32.0	33	10.1	59.1	21.60	3.3	NA
Utah Power & Light	16⅜	2.35	45.5	24.7	45	12.2	85.1	18.48	3.1	B+
Wisconsin Electric Power	23⅛	3.53	NM	9.7	26	11.6	75.9	32.53	2.9	B

[1]Source: TE Desmond Co. [2]Principal source: Argus Research Corp. [3]Source: Salomon Brothers. [4]Parent of Tampa Electric. NA: Not available. NM: Not meaningful. nil: negligible.

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PUBLICATION HAVE BEEN FILMED

Cover 1, p. 2-3, 26, 94, 96,

114-118, 121-124, 126, 130-

132, 134, 138, 140, 144, 146,

171-172, 184, 189-191.